

**MINUTES
of the
SECOND MEETING
of the
INVESTMENTS AND PENSIONS OVERSIGHT COMMITTEE**

**October 16-17, 2006
State Capitol
Santa Fe**

The second meeting of the Investments and Pensions Oversight Committee for the 2006 interim was called to order by Representative John A. Heaton, chair, on Monday, October 16, 2006, at 9:30 a.m. at the State Capitol in Santa Fe.

Present

Rep. John A. Heaton, Chair
Sen. John Arthur Smith, Vice Chair
Rep. Donald E. Bratton
Sen. Joseph J. Carraro
Rep. Miguel P. Garcia
Sen. Phil A. Griego
Rep. Larry A. Larranaga
Sen. Carroll H. Leavell
Rep. Henry Kiki Saavedra
Rep. Luciano "Lucky" Varela

Absent

Advisory Members

Douglas Brown, State Treasurer
Frank Foy, Educational Retirement Board
(ERB)
Robert Gish, Public Employees
Retirement Association (PERA)
Sen. Stuart Ingle
Rep. Patricia A. Lundstrom
Rep. Kathy A. McCoy
Olivia Padilla-Jackson, State Board of
Finance
Rep. Joe M Stell

Gary Bland, State Investment Council
Sen. Pete Campos
Sen. Carlos R. Cisneros
Sen. Joseph A. Fidel
Rep. Justine Fox-Young
Sen. Leonard Lee Rawson
Sen. H. Diane Snyder

Staff

Michelle Aubel, Legislative Finance Committee (LFC)
Doris Faust, Legislative Council Service (LCS)
Norton Francis, LFC
Cleo Griffith, LCS
Larry Matlock, LCS
Doug Williams, LCS

Guests

The guest list is in the meeting file.

Monday, October 16

Recommendations of the Governor's Ethics Reform Task Force; Gifts, Conflict of Interest —Stuart Bluestone, Office of the Attorney General

The governor's original instructions were for the task force to consider ethics in general, not just campaign finance reform.

The proposed state ethics commission would have the power to investigate and recommend action to the employer. The legislative branch would continue to discipline its own members through the impeachment process. The judicial branch already has an ethics review process.

The commission would consist of eight members supported by a full-time staff with an executive director. Four commission members would be appointed by the governor and the remaining four would be appointed by the House and Senate minority and majority leaders. No more than four members may be from the same political party. Five votes would be needed to take action, thus ensuring bipartisan support.

Thirty-nine other states already have an ethics commission. Creation of a New Mexico ethics commission would enhance the oversight of investments and pensions.

The Governor's Ethics Reform Task Force developed recommendations with respect to the following:

1. Establishment of a state ethics commission.

The establishment of an independent state ethics commission will promote increased accountability for ethical behavior among state officials and employees, lobbyists and those that conduct business with the state. The threat of investigation of unethical conduct and sanctions for such conduct could serve as a deterrent for unethical practices in state government. It could also ensure that appointing authorities are made aware of unethical practices of officials and employees and lead to removal of unethical individuals from public service positions. The provision of training sessions and educational materials such as a plain language ethics guide and a business ethics guide would additionally educate state officials and those that conduct business with the state as to what constitutes ethical and unethical behavior. Individuals with such training are less likely to engage in behavior that raises ethical questions. Thus, the training provided by the state ethics commission could protect both public servants and the state agencies by which they are employed.

2. Limitation of the receipt of gifts by state officials.

- Prohibit gifts with a fair market value greater than \$250, unless the gift is accepted on behalf of the state of New Mexico.
- Establish a \$1,060 cap on gifts from a lobbyist, a lobbyist's employer or government contractor to any one recipient who is a state official or state employee.
- Establish reporting requirements for gifts that exceed \$100 in value and ban gifts exceeding that value during legislative sessions.
- Ban gifts to charities designated by state officials in their official capacities.
- Provide criminal penalties for the donation or acceptance of gifts in violation of the new prohibitions.

Although legislators, state officers and state employees are prohibited from receiving anything of value in exchange for performance of an official act, there is no general prohibition of gifts or requirement for disclosure of gifts in New Mexico. Clear designations as to when gifts are not acceptable and additional reporting requirements with respect to gifts provided by lobbyists and lobbyists' employers would provide a necessary foundation for the effective regulation of lobbying and campaign finance. Such designations and requirements would also simplify compliance and ultimately increase public confidence in government. Moreover, clear limitations or even outright bans on gifts have been enacted in most states. The enactment of clear limitations on gifts in New Mexico and additional reporting requirements will ensure that this state is also adapting to the national trend toward limiting the potentially corrupting influence of gifts.

3. Establishment of campaign contribution limits and increased campaign reporting requirements.

- Limit contributions to candidates for statewide office to the federal contribution limit for individuals, currently \$2,100.
- Limit contributions to candidates for districtwide offices to one-half of the federal contribution limit for individuals, currently \$1,050.
- Prohibit cash contributions of more than \$100.
- Strengthen campaign reporting requirements and enforcement.

New Mexico is one of a minority of 13 states that do not limit most campaign contributions. The United States Supreme Court has recognized that campaign contribution limits may serve a state's compelling interest in preventing corruption and the appearance of corruption in the political process. The United States Supreme Court has also concluded that reasonable contribution limits do not violate the United States Constitution. Contribution limits could further limit the influence of large donations, which might breed undue influence and erode public confidence. Thus, the task force agreed that reasonable contribution limits should be placed on contributions to candidates. The task force found that federal limits would constitute reasonable limits and ensure constitutional compliance.

4. Provision of legislative compensation.

- Provide for legislative expense reimbursement accounts in an amount not to exceed \$10,000 annually.

- Prohibit the use of campaign funds for legislative purposes.

Because legislators do not receive compensation for the costs incurred in the performance of their duties, they are faced with a dilemma. They must either personally absorb the costs of serving constituents, or use campaign funds to pay those costs. If campaign funds are used for the costs of serving constituents, the potential for corrupting influence might exist. Legislators might become dependent on funds given to them by third parties that promote special interests. On the other hand, task force members agreed that legislators should not be expected to personally absorb the costs of serving constituents. This expectation might also discourage diverse populations from running for legislative office because only more affluent candidates capable of absorbing the costs of legislative office can afford to serve. To reduce the potential influence of third parties in the legislative process and to provide legislators with some means of reimbursement for the expenses that they personally pay, the task force agreed to seek repeal of the section of law that permits the use of campaign funds for legislative expenses and to request provision of a legislative expense reimbursement account in the amount of \$10,000 annually to each legislator. The task force's recommendation to prohibit the use of campaign funds for legislative purposes is contingent upon the provision of legislative expense reimbursement accounts. Both recommendations are contingent upon the provision for increased campaign contribution limits contained in this recommendation report.

5. Establishment of appointive offices and minimum qualifications for the state treasurer and state auditor.
 - Make the office of the state treasurer an appointive office.
 - Make the office of the state auditor an appointive office.
 - Require the state treasurer to have certain minimum qualifications.
 - Require the state auditor to have certain minimum qualifications.

If the state treasurer and state auditor engage in unethical practices, they can only be removed from office by impeachment, which is a drastic, time-consuming and burdensome process. If the offices of state treasurer and state auditor become appointive, however, the appointing authority would have the power to remove those officials expeditiously, and sooner prevent the officials from engaging in additional unethical practices. The threat of removal by the appointive authorities might also serve as a deterrent to unethical behavior. In addition, the appointing authority could be held accountable for its appointment decisions. Finally, appointment can allow for the establishment of minimum qualifications for the offices of the state treasurer and state auditor. Minimum qualifications can ensure that these officials are professionals who understand the functions of the offices that they are running and who are capable of competent, ethical and professional service to the people of New Mexico.

6. Publicly financed elections.
 - Provide for public financing of all statewide and contested judicial court elections.

Public financing of campaigns has been credited with reducing the adverse effects of money on the political system, increasing the number and diversity of candidates for state office, reducing the need to divert attention to fundraising activities and encouraging candidates to

directly contact all classes of voters. States that have successfully implemented public financing systems include Arizona, Connecticut, Maine, New Jersey and North Carolina. Public financing systems have also taken effect in New Mexico. In 2003, the legislature passed, and the governor signed, the Voter Action Act, creating public financing for Public Regulation Commission races. Additionally, in 2005, Albuquerque voters approved a ballot referendum to develop a system of public financing for future mayoral and city council races.

Representative Lundstrom asked about reporting gifts during the legislative session. It was noted that there would be no reporting of gifts during the session, provided that no one gift exceeds \$100.

Representative Bratton asked about abuse by 527 organizations, large group functions (dinners, etc.) that do not target one specific legislator and the governor receiving free transportation on a jet aircraft.

Senator Leavell also asked about the governor traveling at someone else's expense.

Mr. Bluestone stated that the task force considered the same issues raised by Representative Bratton and Senator Leavell. He said that the task force is only making recommendations and that the exact wording of legislation would be up to the legislature in January.

Representative McCoy stated that a person who wants to "beat the system" will always find a way. She feels that there are too many restrictions being proposed for otherwise honest people.

Representative Saavedra stated that state officials need to go slow when enacting limitations on gifts. He is not enthusiastic about all the reporting requirements because a crook will still be a crook.

New Mexico is one of only 13 states that have no campaign contribution limits.

Representative McCoy wants real ethics reform, not just the perception of reform. She is concerned that corrupt people will figure a way to take money illegally. Also, she believes that contribution limits must be linked to legislator compensation, i.e., there should not be limits until there is a system of compensation in place.

Mr. Brown endorsed the recommended change to appointing the state treasurer and auditor of accounts.

Representative Lundstrom would like to be certain that any ethics reform that applies to legislators also applies to the governor and judges.

Representative Larranaga is concerned about the board of the ethics commission being truly independent. He cited the boards of transportation, retiree health care and university

regents as all being dependent on the governor. He noted that only the board of PERA is relatively independent because some members of the board are elected by members of the PERA system.

Representative Larranaga asked if the task force explored the subject of term limits. The task force did not.

Representative Bratton stated that he knows of a recent example of a board member who was told that if he did not support the governor's position, he would be removed from the board.

Representative Garcia believes that the proposed ethics commission should be prohibited from investigating anything that has to do with the exercise of freedom of speech. He also wants a complete ban on contributions from contractors. Mr. Bluestone stated that the task force has made its recommendations and that it is up to the legislature to accept, modify or add items and then enact them.

New Mexico Finance Authority (NMFA) Investments; Internal Controls, Conflict of Interest

—John Duff, Chief Investment Officer, NMFA

The NMFA has a very conservative approach to managing investments.

- The NMFA obtains funds by issuing tax-exempt bonds and then loans the bond proceeds to cities, counties and other departments of state government.
- The NMFA holds the bond proceeds for a relatively short time. Funds are often disbursed immediately after a bond issue, and, in any event, are required by the United States Treasury regulations to be expended in three years or less.
- NMFA must deliver the agreed-on loan amount to its borrower and cannot accept the risk of investments that have fluctuating market values, such as stocks. The NMFA avoids this risk by investing in fixed-income (bond) types of investments that will mature with a predetermined value. NMFA matches the maturities of its investments to the timing of its cash disbursement requirements.

Permitted investments for the NMFA are defined by Section 6-10-10 NMSA 1978 and are the same as permitted for the New Mexico state treasurer and county treasurers. Permitted investments include:

- certificates of deposit (with any amounts not insured collateralized with United States government securities);
- AAA-rated money market mutual funds;
- United States Treasury securities;
- United States government agency securities;
- the state treasurer's LGIP fund; and
- repurchase agreements and other types of guaranteed investment contracts (with the investment amount collateralized by United States government securities).

The investment policy statement contains important provisions to prevent conflicts of interest and ensure that the best investment management practices are followed.

- Competitive bids are required for the purchase or sale of all investments (a minimum of three; in practice, more are usually obtained).
- For securities purchases and sales, the institutional trading desks of broker/dealers are dealt with directly. (NMFA does not deal with individual brokers who would be paid commissions.)
- NMFA has a list of approved broker/dealers with whom it transacts securities purchases and sales. The list is reviewed and approved annually by its Investment Committee.
- NMFA has an Investment Committee, a subcommittee of its board of directors, which meets monthly to review and evaluate individual transactions, overall investment philosophy and our assessment of market conditions. The Investment Committee reports monthly on the investment program to the board of directors.
- NMFA retains a consultant, First Southwest Asset Management, to independently review its portfolio and report monthly directly to the Investment Committee. First Southwest participates in every Investment Committee meeting and is available to consult with NMFA management on investment issues on a day-to-day basis.
- The NMFA retains an internal auditor to examine its investment transactions (and other aspects of NMFA operations) on a regular basis. The auditor is an independent contractor who is selected on a competitive request for proposal (RFP) basis.
- Independent auditors examine NMFA investment transactions annually.

NMFA procurement policies, which are virtually identical to state policies, require that all professional advisors, such as First Southwest Asset Management, are selected on a competitive RFP basis. (First Southwest was selected in such a process.)

NMFA personnel policies prohibit an employee from accepting gifts of any sort and of any value from any person or company doing business or seeking to do business with the NMFA.

Representative Larranaga asked about bond ratings in the context of the risk level of NMFA borrowers. Mr. Duff stated that NMFA charges different interest rates to its borrowers depending upon their credit rating and the rating agencies take into account the risk of loan repayment when establishing the rating of any particular bond issuance.

Representative Larranaga asked about compliance with arbitrage requirements. Mr. Duff said the NMFA retains an outside consultant that monitors its disbursements to ensure compliance.

Representative Larranaga asked about the composition of the NMFA board. Mr. Duff stated that all of the members are appointed by the governor.

Ms. Padilla-Jackson encouraged NMFA to use electronic trading in order to improve transparency of investments. Mr. Duff stated that NMFA now uses the Bloomberg system of electronic trading.

Status of the Water Trust Fund; Water Project Fund

—Jana Egbert, NMFA, Senior Program Administrator

The 2001 legislature, through the Water Project Finance Act, created the Water Trust Board, a 15-member board empowered to assist the New Mexico Legislature in prioritizing and funding water projects statewide. In creating the Water Project Finance Act, the legislature made the following findings:

- New Mexico is in a desert where water is a scarce resource;
- the economy depends on reasonable and fair allocation of water for all purposes;
- the public welfare depends on efficient use and conservation of water;
- New Mexico must comply with its delivery obligations under interstate compacts; and
- public confidence and support for water use efficiency and conservation are based on a reasonable balance of investments in water infrastructure and management.

The legislature stated that the purpose of the act is to provide a financing mechanism to promote water use efficiency, water resource conservation and protection, and fair distribution and allocation of water to all users. To this end, the act created the Water Trust Fund and the Water Project Fund to provide the necessary financial framework and created a 15-member Water Trust Board. The Water Trust Fund was created in the State Treasurer's Office to be invested by the state investment officer in a manner similar to land grant permanent funds. Money in the Water Trust Fund may not be expended for any purpose, except for an annual distribution made to the Water Project Fund. On July 1, 2006, the Water Trust Fund received a \$40 million general fund appropriation.

The Water Project Fund was created in the NMFA, which provides staff support to the Water Trust Board and makes loans or grants to qualified entities for projects prioritized by the board, approved by the legislature and on terms and conditions established by the Water Trust Board and the NMFA Board of Directors. The NMFA is authorized to recover from the fund the costs of administering the fund and originating loans and grants.

The Water Trust Board is charged with prioritizing projects for recommendation to the legislature for financing from the Water Project Fund and the Water Trust Fund and adopting rules and regulations governing the terms and conditions of grants or loans made from the Water Project Fund. By statute, the Water Trust Board may fund four types of projects:

- storage, conveyance and delivery of water;
- implementation of the federal Endangered Species Act collaborative programs;
- restoration and management of watersheds; and
- flood prevention.

The 2003 legislature, through House Bill 200, transferred the \$5 million appropriation for dam rehabilitation projects statewide from the Water Project Fund to the Office of the State Engineer. The transfer occurred during fiscal year 2004 and all pending dam rehabilitation project applications made to the Water Trust Board were given to the Office of the State Engineer. One of the most significant events in fiscal year 2003 was the passage of House Bill 882, which dedicates 10 percent of the severance tax bond (STB) proceeds to the Water Project

Fund for use by the Water Trust Board to fund water projects statewide. The legislation requires that, by January 15 of each year, the Board of Finance Division of the Department of Finance and Administration shall estimate the amount of bonding capacity available for STBs to be authorized by the legislature. In expectation of this funding capacity, the Water Trust Board solicited letters of interest from projects wishing to apply to the Water Trust Board for this funding.

The 2005 legislative session also produced another piece of legislation that could impact the board. House Bill 1110 will transfer 10 percent of the Water Trust Board funding to the state engineer for water rights adjudication. Twenty percent of the money dedicated for water rights adjudications will be allocated to the Administrative Office of the Courts for the courts' costs associated with those adjudications. The Office of the State Engineer and the Administrative Office of the Courts will use this funding to address the backlog of cases. However, after enactment, several concerns about the structural issues of the legislation were raised. As such, implementation for HB 1110 has been postponed for one year.

The State Board of Finance informed the Water Trust Board in the spring 2006 that \$27,926,527 was available for funding water projects, including the 10 percent set-aside to fund adjudication for 2005 and 2006. All available funds were fully allocated for the projects in fiscal year 2005 for 19 projects statewide. The Office of the Attorney General opined this appropriation was valid and not discretionary. NMFA staff recommend to the Water Trust Board in the April 26, 2006 board meeting that both 2005 and 2006 adjudications be deducted from the available 2006 STB proceeds. The remainder of the funds, \$23,361,734, was used to fund 25 of the legislative-approved projects in the form of a grant and loan combination (see Tables 2 and 3).

In 2006, the Water Trust Board changed its practice of providing only grant funding for projects. NMFA staff, at the direction of the Water Trust Board, started evaluating potential loan and grant criteria that are fair to all eligible entities under the Water Project Finance Act. A simple formula for all projects that could be easily understood by all stakeholders was developed by NMFA staff with the consideration of the diversity of the nature of the entities and the services provided to their constituents. A two-step implementation process was approved whereby all projects in 2006 would be structured as 90 percent grant, 10 percent no-interest loan (with a modest administrative fee of one-fourth percent); in 2007, the formula will be adjusted to 80 percent grant, 20 percent loan for all projects. These loans would not impair existing and planned debt by securing the loans with a subordinate pledge of the net system revenues of the entity. The loans would be 10 to 20 years in term, with no penalty for any prepayments, with longer maturities available for dam rehabilitation, water delivery and water reuse and conservation projects, and shorter terms available to watershed restoration and federal Endangered Species Act collaborative projects. As a final point, given the unpredictable nature of the revenues for many entities, the loans would be structured to allow hardship waivers of annual principal payments for those entities unable to meet their debt service as determined by the Department of Finance and Administration.

The Water Trust Fund will distribute \$4 million annually to the Water Project Fund until such time as 4.7 percent of the five-year average ending fund balance exceeds \$4 million, and then the distribution will be 4.7 percent of that average ending balance.

Senator Carraro asked about the criteria used to make loans versus grants. Ms. Egbert stated that currently all projects are funded 10 percent as a loan and 90 percent as a grant. The entire project is subject to a one-fourth percent administrative fee and the loan is at zero percent interest.

Governor's Water Initiative

—Estevan Lopez, Deputy State Engineer

—Bill Hume, Director of Policy Issues

Since taking office, the governor has focused more than \$74 million in key federal and state funding on urgently needed water projects in communities throughout New Mexico, particularly in rural areas. Governor Richardson directed more than \$30 million in emergency federal aid to community water projects, along with supporting and approving nearly \$44 million in capital outlay funding for similar projects. This year, the governor supported and signed into law legislation to improve the state's control over water use, recovery and conservation efforts. This legislation:

- expanded the use of the state's Corrective Action Fund to allow the New Mexico Department of Environment to use a portion of funding to protect and improve the quality of New Mexico's water and to facilitate cleanup of ground water sources; and
- gives the state engineer authority over the use of surface water for livestock purposes and eliminates loopholes and gaps that allow improper use of water, such as raising fish under "stock tank" regulations.

Senator Carraro asked about an inventory of the San Juan. Mr. Lopez stated that a complete analysis of the San Juan has been finished in conjunction with the Navajo water settlement agreement. It has been determined that there is sufficient water to meet New Mexico's obligations.

Representative McCoy indicated that more money should be allocated for adjudication of water rights so that state officials know the total amount of water in New Mexico.

Representative Garcia asked for an example of "best water practices". Mr. Hume stated that desalinization and purification of wastewater are two examples.

Representative Larranaga asked about the governor's plan to augment the Water Trust Fund. Mr. Hume stated that the governor is proposing to add \$25 million to the existing \$40 million trust fund that was appropriated in the 2006 session.

Representative Larranaga asked about public-private partnerships. Mr. Lopez indicated that the Salt Basin Project is an example of public-private partnership.

Representative Lundstrom asked for a report from the state engineer on the use of the \$10 million for demonstration projects.

Department of Public Safety (DPS); Motor Transportation Division; Change in Retirement Plan

—Richard Newman, Adjutant Chief, DPS

—Ron Cordova, Captain, DPS

The DPS is comprised of three law enforcement entities: the New Mexico State Police Division, the Motor Transportation Division and the Special Investigations Division. While all three divisions have specific law enforcement missions, all three are comprised of certified law enforcement officers and all three have officers serving the state in hazardous duty assignments. Members of only one division, the New Mexico State Police Division, have a 25-year enhanced retirement system, which is a system that has become standard for law enforcement officers across the state. The Motor Transportation Division and the Special Investigations Division have requested coverage under the State Police Member and Adult Correctional Officer Member Coverage Plan I retirement plan.

This would not only improve the morale within the department, it would greatly assist the divisions in both recruitment and retention. Currently, the Motor Transportation Division and the Special Investigations Division have vacancy rates that are higher than that of many state agencies. There is difficulty attracting personnel to the divisions, and they are losing talent to other law enforcement agencies because of the lack of a 25-year enhanced retirement system. If approved, there will be a total of 150 officers within the Motor Transportation Division and 37 members of the Special Investigations Division affected by the change. There is an actuarial study being conducted at this time in order to determine the fiscal impact of such a move. The actuarial study should be completed by next month. If approved, DPS anticipates the change would take place in July 2007 and would affect both current and new employees.

The police officers of the Motor Transportation Division and the Special Investigations Division are seeking a 25-year enhanced retirement plan as are the regular state police. The 25-year enhanced plan means that an officer can retire at 20 years and 10 months with 75 percent pay.

Mr. Newman stated that an actuarial impact has been requested from PERA.

It was noted that the Special Investigations Division currently has 37 employees and a 40 percent vacancy rate. The Motor Transportation Division has a 14 percent vacancy rate and 149 officers. The assertion is that recruitment and retention could be improved with the retirement plan enhancement.

Representative Saavedra stated that he would like the actuarial report from PERA before making a decision on support of the request. He also noted that 20 years is long enough to work as a law enforcement officer.

District Attorneys; Change in Retirement Plan

—Randy Saavedra, Director, District Attorneys

There is a problem with retention of district attorneys that results in inexperienced district attorneys going to court with experienced defense attorneys. Also, there is a great deal of stress associated with the job, similar to that in firefighting and law enforcement.

Senator Griego asked about how many attorneys actually stay until retirement. Mr. Saavedra stated that only about 5 percent of attorneys stay until retirement. He believes that a 20- year retirement plan would be an incentive to stay, although the stress of the job would not change.

Representative Saavedra stated that it is advantageous to have experienced district attorneys to counter experienced litigators.

Representative Lundstrom requested that actuarial studies be made available to the committee members.

Representative Bratton stated that the committee is attempting to approach changes in retirement plans in an organized fashion that ensures equity and fiscal responsibility.

Representative Larranaga asked how many district attorneys would receive the enhanced retirement benefit. Mr. Saavedra stated that 206 attorneys are involved. He also noted that they have a 33 percent turnover rate.

Tuesday, October 17

Review of Retirement Benefits; PERA and ERB

—Terry Slattery, PERA, Executive Director

The current status of the pension plan was summarized as follows:

- \$10.2 billion in assets as of 6/30/05;
- \$11.3 billion in assets as of 6/30/06, a gain of \$1.1 billion for the fiscal year;
- 91.7 percent funded ratio as of 6/30/05;
- 9.85 percent investment return as of 6/30/05, exceeding eight percent benchmark;
- 11.74 percent investment return as of 6/30/06;
- PERA's investment performance has placed PERA in the top 22 percent of large public pension funds throughout the United States.
- total investment earnings over the past 10 years exceeded \$7.38 billion (based on invested assets of \$3.92 billion as of 6/30/1996) with an annualized return of 9.9 percent over the 10-year period, placing PERA in the top 6 percent of public funds for the 10-year period;
- in the 2006 legislative session, the legislature gave PERA the authority to expand the types of investments with the goal of maximizing investment opportunities. These

- expanded investment opportunities will change the way PERA has traditionally invested trust fund money;
- in September 2006, the PERA board approved allocations to an energy fund and a private equity fund. Allocations will continue to be considered by the Board until the overall 15 percent of the portfolio target is reached. It is anticipated this process will take approximately three years to complete;
 - PERA has reached a level of maturity as a pension plan where employee and employer contributions no longer generate enough cash flow to fund the increasing number of PERA retirements; and
 - PERA's investment income makes up the shortfall between employee and employer contributions to pay retiree and beneficiary pensions.

PERA administers 31 different retirement plans for state, municipal, judicial, magistrate, legislative and volunteer firefighter members. As of June 30, 2005:

PERA Active Members	47,711
—Average Age	42.6 years
—Average Service Credit	7.9 years
—Average Annual Salary	\$33,700
PERA Deferred Vested Members	3,265
PERA Retired Members	21,396
—Average Annual Pension Amount	\$20,431
—Average Retiree Age	65.1 years
—Average Age at Retirement for State General	57.7 years
—Average Age at Retirement for State Police	51.5 years

Regarding retirees returning to work:

- in 2003, the legislature passed legislation allowing retirees to return to work and receive both a pension and a salary;
- approximately 1,500 retirees have returned to work under these provisions, or approximately 6.25 percent of PERA's retired members;
- as of December 31, 2006, a retired member who has returned to work will no longer be required to pay nonrefundable employee contributions after earning \$25,000 in salary;
- as of January 1, 2007, the employer will be responsible for paying the full actuarial cost of hiring retirees to fill positions;
- PERA's actuary observed that, in general, experience indicates that members are retiring at significantly higher rates than currently assumed during the first several years of service-based eligibility;
- the incentive to work until a member can retire with a pension maximum, instead of when first eligible to retire, was affected when retirees became eligible to retire, receive a pension and receive a salary; and
- PERA's actuary is in the process of determining whether or not there was a cost to the retirement system for retirees returning to work and receiving a pension check as well as a salary. The actuary estimates that he will complete the cost study in early

December, at which time PERA will notify the legislature and employers of the findings.

Representative Bratton asked about the nature of the Legacy System data problems. Mr. Slattery stated that the data problems relate to credited service. PERA is mailing statements to members asking them to verify the data. If there is a discrepancy, PERA contacts the employer to confirm the information supplied by the member.

Representative Larranaga asked about the number of active members that have data problems. Mr. Slattery stated that approximately 50,000 member records need to be audited to be certain.

Representative Heaton asked who has the burden of proof in resolving data discrepancies. Mr. Slattery said that the burden is with the employer.

Senator Carraro expressed concern about the total liability of the state related to the generous PERA Plan 3 benefits. Mr. Slattery stated that PERA is prefunded, actuarially sound and in no danger of defaulting on pension payments.

Representative Larranaga is opposed to return to work when it is detrimental to other employees' career advancements.

Mr. Foy stated that the legislation passed in 2005 increases the employer contribution 75 basis points per year for seven years and 7.5 basis points for the employee for four years. The current ERB-funded ratio is 70.2 percent. It is estimated that five years from now, the unfunded liability will be 80 percent and the time needed to reach 100 percent funded will decrease from infinity to 30 years, consistent with GASB requirements.

Senator Griego asked about the actuarial impact of all the groups that are coming to the committee seeking enhanced retirement benefits. Mr. Slattery noted that it is basically a policy decision. In the case of the state police, the conversion would reduce the liability of the state general plan and increase the liability of the state police plan.

Representative Heaton suggested that the PERA return-to-work provisions should be the same as the ERB provisions, i.e., a one-year layout rather than only 90 days.

Representative Heaton requested a side-by-side comparison of ERB and PERA retirement features.

—Paul Swanson, ERB

The current status of the pension plan was summarized as follows:

- 68,135 active members
 - Increased 1.6 percent per year since 1994
 - Average pay, \$34,865

- Average age, 45.6
- 28,050 retirees
 - Increased 4.7 per year since 1994 - average benefit, \$17,594
- 2.5 active members per retiree
 - 1994 - 3.4 active members per retiree
- Educational Retirement in NM 2006

○ 2004 Retirements	1,512
○ 2005 Retirements	1,726
○ 2006 Retirements	1,924
○ June 2006 Retiree Payroll	\$41.1 million
○ August 2006 Retiree Payroll	\$44.1 million
○ Number of Refunds FY05	8,740
○ Total Amount Refunded	\$28.1 million

The eligibility rules for retirement and the annuity options are as follows:

- five years and age 65
- Rule of 75: age plus earned years equal 75
- 25 years of earned plus allowed (up to five allowed + five military) service credit
- If you are under age 60
 - age 59 to 55 - reduce benefits 2.4 percent each year under 60, e.g., age 55 = 12 percent reduction
 - age 54 to 51 - reduce benefits 7.2 percent each year, e.g., age 51 = 40.8 percent reduction
- Option A (Normal Option)
 - largest amount
 - ends at retiree's death
 - beneficiaries only get balance (if any) of members contributions as lump sums
- Option B
 - benefit is reduced; beneficiary gets the same benefit if the member dies
 - member "pops up" to normal option if beneficiary dies first
 - reduction is based on member and beneficiary's age: higher if member is older and beneficiary younger; under B, the beneficiary is a spouse of any age, or another person no more than 10 years younger than the retiree
- Option C
 - benefit is reduced
 - beneficiary receives one-half of the member's benefit if the member dies
 - reduction based on the member's and beneficiary's age (nonspouse can be more than 10 years younger)
 - reduction is less than Option B
 - if beneficiary dies, member "pops up" to normal option

The cost of living allowance (COLA) for retirees is subject to the following rules:

- starts on July 1 of the year a member reaches age 65
- one-half of the Consumer Price Index (CPI)
 - maximum of four percent

- minimum of two percent or actual CPI if less than two percent
- COLA for 7/1/06 was two percent

A retiree may return to work according to the following rules (no effect on ERB funding status). The retiree:

- can return to work for ERB employer after 12-month layout (no substituting, contracting, volunteering in a typically paid position);
- can continue receiving ERB pension;
- does not earn credit toward increased pension; and
- does not pay into ERB (7.75 percent); employer does pay their 10.4 percent.

There are two types of retirement plans: defined benefit and defined contribution. Defined benefit plans guarantee a lifetime income for the retiree; however, they can be expensive to the employer. Defined contribution plans are becoming increasingly popular because the employer has no lifetime liability.

Representative Larranaga asked about salary augmentation with respect to medical doctors. Mr. Swanson stated that salary augmentation in the final years of service is always a possibility. He does not believe it is a widespread practice.

Seventy percent of ERB retirees elect the normal (Option A) retirement benefit, i.e., the monthly benefits terminate when the retiree dies.

Approximately 1,700 of the 28,000 retirees have taken advantage of the return-to-work program. It has been determined that the return-to-work program does not adversely affect the actuarial status of the retirement fund.

Proposed Study; PERA; House Memorial 34, 2006 Session

—Sheila Pugach

Staff distributed a letter from Ms. Pugach explaining the change that is requested to PERA's retirement calculation. The content of the letter is as follows:

"Oct. 17, 2006

Dear Committee Members,

I respectfully request that you consider changing the retirement calculation from 3 consecutive highest years of salary to 3 highest years of salary.

Although for most people the last three consecutive years of earnings are the years of highest salary, I am in an unusual situation. I worked for over 9 years for the State of New Mexico in Santa Fe. I then returned to Albuquerque and worked for Bernalillo County for 2 years at a very much reduced salary (about \$11,000 less). I then was fortunate to get a position with the City of Albuquerque where I am currently employed and where my salary increased. If I were to retire

within the year, the interim years at the County, which were at a far lower salary than either my State or my City salary, would be counted in my pension (as well as the time I have worked for the City of Albuquerque. This is because of the requirement that the years be consecutive. The higher salary at the State would not be considered in my pension calculation. If I were to retire now, my pension would not benefit from the higher contributions I made while working for the State of New Mexico.

This situation, affects only a small number of people for two reasons. Most people do not have an interim decrease in salary. Also, most people start working under PERA when they are younger and have the years to work and earn three consecutive years at a higher salary. However, State, County and City governments in New Mexico have been very good in hiring middle age people. I have been under PERA for approximately 14 years. The change in the calculation would make a difference in my otherwise low pension.

My situation is quite unusual because of the combinations of both the above reasons. I do not think that the original intent of the legislature was to penalize the few people who might be in this situation.

I request this change in the PERA pension calculation for the following reasons:

- 1) The number of people in this situation would be very small. I personally know of no one else in this situation. The fiscal impact of this should be minimal.
- 2) I think the mechanics of calculating the pension in these cases could be made simple. The salary history could be 'exported' from the current computer system (database) to an Excel spreadsheet where with one click at the top of the salary column, the salary could be sorted in highest order first. This is one possible scenario.
- 3) Just as there are many special cases such as purchasing time for Military or people who have worked out of State, airtime etc. one could make this calculation only for those people who request it in writing. In other words it could be done on what one would call an 'exception' basis. There are many exceptions now as I have read in the La Voz.
- 4) I do not consider this request an enhancement of the PERA pension, but an adjustment to what I think were unintended consequences of the requirement of three consecutive years. It is also a matter of fairness.

Thank you for your consideration."

Mr. Slattery indicated that PERA is opposed to the change.

The committee voted not to support the requested change.

Adoption of September 6, 2006 Minutes

The committee unanimously adopted the September 6, 2006 minutes.

Deferred Compensation Overview

- Kurt Weber, PERA Deputy Director
- Joanne Garcia, PERA
- Jim Keeler, Nationwide Investment Services

The status of the deferred compensation plan as of June 30, 2006 is as follows:

- plan assets - \$274 million (\$26 million increase from 6/30/05);
- quarterly contributions - \$6.4 million;
- quarterly distributions - \$2.4 million;
- plan participants - 12,939;
- participating employers - 93 (includes state, county, city, schools, universities and special districts);
- 13 new employers affiliated since 6/30/06; and
- new contacts have been made with various state universities this past year.

Nationwide has a local office in Santa Fe with four representatives that cover the state.

In the past year, they have accomplished:

- new enrollments - 1,159;
- increased contributions - 19,967;
- deferrals increased by 10 percent in an 18-month period (12/31/05 through 6/30/06);
- reinstatements - 78;
- group meetings - 933; and
- asset allocations increased by 35 percent in the same 18-month period.

The investment options available to a participant are:

- 16 mutual fund core investment options (includes stable value option);
- five lifecycle portfolios - implemented 2/25/05:
 - 963 participants currently invested in the portfolios; and
 - 688 in the last year;
- tied to anticipated retirement date;
- custom designed utilizing several funds from the core investment options. Provide diversification;
- constructed and reviewed quarterly by the PERA board and plan investment consultant. Poor performing funds are replaced as necessary;
- no additional fees other than standard fees charged by individual component mutual funds;
- self-directed brokerage account option - implemented 2/14/05:
 - initially mutual funds only; and
 - recently added exchange-traded funds (ETFs) offered by Vanguard and BGI;
- changed from Harris *direct* to Schwab:
 - increase in the number of participants; and
- loan program - implemented 10/22/04:
 - charge interest at prime rate plus one percent; and
 - up to five years to repay general purpose loan and 15 years for purchase of primary residence.

Representative Varela asked about the advice that Nationwide provides to participants. Mr. Weber stated that Nationwide does not give participants advice; however, the lifecycle plans offer diversification and rebalancing for participants.

Representative Varela asked Mr. Foy if ERB offers a deferred compensation plan. Mr. Foy said that it is the responsibility of each school district to contract for a deferred compensation plan for its employees.

Representative Varela asked about accounting problems. Mr. Weber stated that there is a significant time delay in posting employees' contributions to their individual accounts. As of today the accounting system is current through June 30, 2006. Representative Varela suggested that resources need to be directed toward making the accounting system more timely.

Representative Larranaga asked if participating agencies advertise the benefits of deferred compensation plans. Mr. Keeler stated that newsletters and pay envelope enclosures are used to promote participation.

Representative Bratton asked about contribution limits. Mr. Keeler said that for persons under age 50, the maximum annual contribution is \$15,000; for persons over 50, the maximum is \$20,000.

University Campus Police; Change in Retirement Plan

—Deputy Chief Steven Lopez

The public higher education institutions in New Mexico are seeking approval of legislation to authorize the move of certified police officers from the educational retirement system to the public employee retirement system. This move is being sought in order to attain parity with the other law enforcement agencies in New Mexico and thereby improve recruitment and retention of high-quality officers to protect the students and staff at the four-year institutions. The plan has been developed with the assistance of both the ERB and the PERA directors and legal staff. It should have no impact on the solvency of either plan and does not require the transfer of any funding between the plans. A total of 78 current employees would be affected.

The ability to recruit and retain police officers in New Mexico has reached a critical level, and university police departments have been hard hit. One of the primary challenges identified regarding the ability to recruit and retain officers is disparity between the ERB (where university officers are currently placed) and the PERA (where all other police officers in the state are placed). The differences are so great that an officer who works for a university for five years will be able to leave to work for a municipality and still retire sooner and at a higher rate of retirement than if the officer continued to work for the university. This has led to a number of experienced officers leaving after universities have paid for their initial academy and training. The end result is that the experience level at the universities has shrunk, while the expense of training has increased. Furthermore, attempts at recruiting new officers have been met with decreasing numbers of qualified applicants, as other agencies recruiting from the same pool are

able to offer better benefits. In order to halt the exodus of experienced officers and level the recruitment playing field, discussions have been held with the ERB and PERA directors about options.

Based on the analysis and suggestions provided by the two retirement system directors and their staff, the best course of action is to move university police officers from ERB to PERA. Both systems support this move, with the condition that it be prospective (money will not be pulled from ERB and PERA will not incur liability for years contributed under ERB). This means that current officers will end up getting a "mixed" retirement upon eligibility, with their years contributed under ERB being calculated at the ERB rate, and years under PERA at the PERA rate. The plan identified by PERA as the most appropriate for placement is the State Police and Adult Correctional Officers Plan. Both systems agree that legislative changes will need to be made to the Educational Retirement Act to allow the movement of the affected employees.

Per the recommendations of the retirement systems, employees who are currently in ERB would leave their contributions in that system and would start contributing to PERA on the transition date. When their years of service equal 25 years combined between the two systems, they would be eligible to retire. Upon retirement, the employee would be paid from the ERB system for their time paid into ERB and at the ERB rate. Time paid into PERA would be paid by PERA at the PERA rate. The retiree would receive a single retirement check that has been combined by the two systems. Both systems indicate this is currently what happens with a number of other employees in the state when someone moves from one system to the other and then retires under a combination of the two. As a result, there is already a mechanism in place for handling this type of combined retirement. Any legislative changes made to the two systems in the future in order to ensure solvency would apply to the employees based on their portions of funds paid into the respective systems, helping to ensure that there is no adverse impact on either system.

Mr. Slattery noted that the proposed migration would not be a detriment to PERA because the police would be paying their own way.

Robert Schulman of ERB stated that the proposed migration could lead to a mass exodus in favor of PERA. After consulting with its actuary, ERB no longer supports the move.

Committee Discussion of Topics for the November Agenda

—Doug Williams, LCS

- 9:30 a.m. Composition of the Boards of ERB, PERA and SIC
 —Committee discussion with board chairs and/or members
- 11:00 a.m. ERB Actuarial Update
- 1:00 p.m. SIC Student Managed Investment Program
 —UNM and NMSU \$10 million initiative (total)
- 1:30 p.m. SIC Economic Investments
 —Film investments, etc.

2:00 p.m. Juvenile Correctional Officers; Retirement Benefit Enhancement
2:30 p.m. Adult Correctional Officers; Retirement Benefit Enhancement
3:00 p.m. 911 Communications Workers; 20-Year Retirement
3:30 p.m. Committee Discussion of Draft Legislation, if any, (to be prepared by LCS for
 consideration at the December 20, 2006 meeting)

Other Business

There was no other business brought before the committee.

The committee adjourned at 3:00 p.m.